Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-890

GULF & WESTERN INDUSTRIES, INC.,

Cross-Petitioner,

v.

ALLIS-CHALMERS MANUFACTURING COMPANY,

Cross-Respondent.

ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR CROSS-RESPONDENT IN OPPOSITION TO CROSS-PETITION FOR A WRIT OF CERTIORARI

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On October 16, 1975 Allis-Chalmers Manufacturing Company ("Allis-Chalmers") filed a petition for a writ of certiorari (No. 75-580) requesting this Court to review the judgment of the United States Court of Appeals for the Seventh Circuit, which presented a question of the applicability of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), identical to the issue decided by this Court on January 13, 1976 in *Foremost-McKesson, Inc.* v. *Provident Securities Co.*, Docket No. 74-742. Gulf & Western Industries, Inc. ("Gulf & West-

ern'') filed a brief in opposition to Allis-Chalmers' petition. On January 19, 1976 this Court denied Allis-Chalmers' petition. Gulf & Western now requests this Court to review the judgment of the Court of Appeals as to but a single one of the components of the calculation of the amount of ''profit realized'' by Gulf & Western on its purchase and sale within six months of a 248,000 share block of Allis-Chalmers common stock as to which Gulf & Western's liability under Section 16(b) is not in issue. For the reasons set forth herein, Allis-Chalmers requests that this Court deny the cross-petition for a writ of certiorari.

Restatement of Question Presented

If a ''beneficial owner'' purchases and sells within six months securities in violation of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), can calculation of the amount of ''profit realized'' that the ''beneficial owner'' must disgorge be made by reference to the actual amount of dollars received by the insider or must such calculation of ''profit realized'' be made by reference to a hypothetical, substantially lower ''value''?

Restatement of the Case

The petition of Allis-Chalmers sets forth the essential facts underlying the two purchases and sale by Gulf & Western within six months of the listed securities of Allis-Chalmers. These facts will be repeated only to the extent necessary to respond to the single issue presented in Gulf & Western's cross-petition.

In July 1968, Gulf & Western purchased 3,000,000 shares of Allis-Chalmers common stock. This transaction resulted in Gulf & Western's acquisition of approximately 29% of the issued and outstanding shares of Allis-Chalmers.

In August 1968, Gulf & Western agreed that it would purchase 248,000 additional shares of Allis-Chalmers stock from The Oppenheimer Fund, Inc. Subsequent to this agreement to make this second acquisition of Allis-Chalmers stock, Gulf & Western, as a result of a conversation with Allis-Chalmers' chairman, became concerned over its substantial holdings of Allis-Chalmers stock. (Pet. App. at 4a + n.4.)*

On September 30, 1968, Gulf & Western closed the transaction for the purchase of the additional 248,000 shares of Allis-Chalmers stock from The Oppenheimer Fund, Inc., and, on that very same day, Gulf & Western commenced negotiations with White Consolidated Industries, Inc. (''White'') for the sale to White by Gulf & Western of its entire 3,248,000 shares of Allis-Chalmers common stock. Gulf & Western and White agreed that, in consideration for the 3,248,000 Allis-Chalmers shares, White would pay $113,680,000 plus an agreed upon amount of White securities. The purchase agreement specified that *White* had the *option* of delivering at the closing White securities plus either $113,680,000 in cash, or $20,000,000 in cash and a six-month promissory note in the aggregate principal amount of $93,680,000 bearing an annual interest rate of 8½%.**

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* Citations to "Pet. App. a" are to the Appendices to the petition previously filed by Allis-Chalmers, Docket No. 75-580.

** The agreement provided in pertinent part:

"In consideration of the mutual covenants contained herein, the parties hereto agree as follows:

1. G&W agrees to sell or cause to be sold to White and White agrees to purchase from G&W, at the Closing, all of the Shares, and G&W agrees to convey to White good and valid title to the shares, free and clear of any and all liens and encumbrances. In consideration therefor, White agrees to pay to G&W cash (in New York federal funds) in the aggregate amount of One Hundred Thirteen Million Six Hundred Eighty Thousand Dollars

On December 6, 1968, after indisputably having become a "beneficial owner" in July, 1968 and a scant two months after its purchase in September 1968 of the 248,000 shares of Allis-Chalmers stock from The Oppenheimer Fund, Gulf & Western closed the sale of its 3,248,000 shares of Allis-Chalmers common stock to White. In return for Gulf & Western's entire interest in Allis-Chalmers, White, exercising its option, paid Gulf & Western $20,000,000 in cash, 250,000 shares of White's unregistered common stock, and a six-month promissory note in the aggregate principal amount of $93,680,000 bearing interest at 8½% per annum (the "White note").

On March 20, 1969—two and a half months prior to the maturity of the note, three and a half months after the closing, and almost *four years* before the trial commenced in the District Court—White delivered to Gulf & Western a check in the amount of $95,948,852.56, representing prepayment of the full face value of the White note plus interest accrued to the date of prepayment.

The Decision of the District Court

The District Court held that Gulf & Western was a statutory insider for purposes of Section 16(b) with respect to profits "realized" by Gulf & Western on all 3,248,000 shares of Allis-Chalmers stock purchased and sold within six months. There was no dispute as to the proper measure of

($113,680,000) and to issue to G&W Two Hundred Fifty Thousand (250,000) shares of Common Stock of White (the "White Shares"). Notwithstanding the foregoing,

(a) *White may, at its option, deliver to G&W at the Closing its 8½%, six-month Promissory Note payable to G&W in an aggregate principal amount of not to exceed $93,680,000 (the "White Note") in lieu of delivering to G&W cash in an amount equal to such aggregate principal amount . . .*" (Emphasis supplied.)

profits—the difference between what Gulf & Western had paid for the 3,248,000 shares and what it had received on their sale within six months. There were, however, differences between the parties as to the valuation of components of the considerations Gulf & Western received and paid, the only one of which is involved in this cross-petition being the value of the White note. Allis-Chalmers took the position* that, for valuation purposes, the White note had to be valued at face value because Gulf & Western had actually received the entire $93,680,000 in cash shortly after the sale. Gulf & Western, however, argued that the White note had to be valued as of December 6, 1968 (the date of the closing), and offered evidence that the White note should be discounted for valuation purposes in determining the amount of profits realized by its violation of Section 16(b), despite the fact that Gulf & Western carried the White note at its full face value in all of its financial statements, in its contemporaneous filings with the Securities and Exchange Commission and the New York Stock Exchange, and in all of its communications with its stockholders. The District Court accepted Gulf & Western's contention and held that the White note, for purposes of computing profit realized, was worth only $88,996,000—a 5% discount—despite the fact that Gulf & Western actually received $93,680,000 (Pet. App. at 65a), plus interest in the amount of $2,268,852.56.

* At trial, Allis-Chalmers relied on the agreement between Gulf & Western and White, quoted in pertinent part above, and the fact of payment of the White note.

The Decision of the Court of Appeals

Allis-Chalmers appealed the computation of the amount of profit realized by Gulf & Western as to all 3,248,000 shares, including the District Court's valuation of the White note. The Court of Appeals reversed the District Court's ruling as to the valuation of the White note and modified the award of profits with respect to the 248,000 Allis-Chalmers shares Gulf & Western had purchased on September 30, 1968 and sold to White on December 6, 1968.* The Court of Appeals simply and logically held that if debt obligations such as the White note have been paid in full prior to trial, they must be valued at their full face amount in computing whether an insider who violated Section 16(b) has realized "any profit".

> "Given the broad remedial purpose of Section 16(b), its limited impact, and the intent of Congress in drafting this section to 'eradicate speculative abuses by reducing difficulties in proof', *Bershad* v. *McDonough*, 428 F.2d at 696, we hold that in transactions involving debt obligations of an amount certain, evidence of payment in full, if available at the time of trial, should control the determination of 'profit realized'. We cannot but wonder whether Gulf & Western's present belief that estimated market value at the time of closing is the only proper measure of 16(b) liability could have withstood the strains of a situation where White had in fact defaulted on the note completely. In any event, a rule of evaluation which looks to the realities in such situations will avoid the possibility that real profits will escape the reach of the statute or that non-existent profits will be 'recovered'. We believe this to be no more nor less than the language of the section requires." (Pet. App. at 33a-34a) (footnote omitted).

* The Court of Appeals reversed the holding of the District Court that Gulf & Western was liable to Allis-Chalmers for all the profits Gulf & Western had realized on the purchase and sale within six months of the initial 3,000,000 Allis-Chalmers shares, for the reason that Gulf & Western was exempt because it was not a "beneficial owner" under Section 16(b) prior to its purchase of approximately 29% of Allis-Chalmers common stock. The Court of Appeals specifically rejected Gulf & Western's claim that it was not a "beneficial owner" when it subsequently purchased the additional 248,000 Allis-Chalmers shares, and Gulf & Western does not dispute this holding.

Reasons for Denying the Writ

The cross-petition for a writ of certiorari should be denied for the reasons that the decision of the Court of Appeals does not conflict with any decision of this Court, or of any other court, and because the issue presented does not involve a recurring question of federal law.*

Gulf & Western unabashedly claims in its cross-petition that the Court of Appeals was wrong in holding that, in determining the amount of "profit realized" under Section 16(b), the Court should not have included in that calculation the actual amount of hard cash—$93,680,000—realized by Gulf & Western when White prepaid the full face value

* Gulf & Western's contention that the holding of the Court of Appeals "constitutes a plain circumvention of the mandate of Rule 52(a) F.R.C.P." (Cross-Pet. at 8) is frivolous on its face. As noted above, the Court of Appeals held *as a matter of law* that discounting a debt obligation in computing profit pursuant to Section 16(b) is improper when the obligation has in fact been paid in full prior to trial. The Court of Appeals did not overturn any finding of fact made by the District Court but merely held that any finding as to the value of the White note as of December 6, 1968 was irrelevant in determining the amount of "profit realized" because the White note had in fact (as found by the District Court) been paid in full prior to trial.

of the White note. Gulf & Western argues that the indisputed evidence of profits actually realized by it must be ignored, and that any determination of "profit realized" for purposes of Section 16(b) can only be made 1) as of the actual date the violative transaction took place and 2) by an estimate of value. (Cross-Pet. at 9.) In sum, Gulf & Western takes the position that "any profit" under Section 16(b) was not intended by Congress to mean "any profit". This approach urged by Gulf & Western is not supported by any legislative history, any court decision, or, we submit, any common sense.

The Court of Appeals held that because the evidence revealed precisely what Gulf & Western actually received as proceeds from the sale of its Allis-Chalmers stock to White, it was unnecessary to utilize either expert testimony or other market data to estimate a hypothetical value for the six-month promissory note. This holding, we submit, is entirely correct.

The Court of Appeals' determination of the actual profits realized was based upon the uncontroverted and unique facts of this case and involved a "rule of evaluation which looks to the realities in such situations". (Pet. App. at 34a.) Here, the seller gave the purchaser the option of either paying all cash or paying a portion in cash and the remainder in the form of a short-term promissory note. This short-term note was paid in full even prior to its maturity. The seller—Gulf & Western—received the full amount of cash it had bargained for shortly after the closing and, more importantly, almost *four years* prior to trial. It is highly unlikely that the situation presented with respect to the value of a debt security such as the White note will recur. In the forty-one year history of Section 16(b), this is the only case in which the issue has

arisen. Gulf & Western can cite no case under Section 16(b) involving actual payment of a debt security by the purchaser to the seller prior to trial. In any event, it is submitted that the Court of Appeals was correct in requiring Gulf & Western to disgorge as "profit realized" by it all actual profits rather than a hypothetically lower sum.

Gulf & Western suggests that the Court of Appeals is in "irreconcilable conflict" with this Court's decision in *Blau* v. *Lehman*, 368 U.S. 403 (1968), by "creating a fiction in holding that G&W must be treated as having received cash on the date of sale". (Cross-Pet. at 8, 12.) This Court in *Blau* v. *Lehman* held merely that a plaintiff could not recover as profits under Section 16(b) from a defendant director those sums received by the partnership of which he was also a partner when it was not shown that the director-partner had been "deputized" by the partnership or had otherwise acted in its behalf. 368 U.S. at 409-10. Here, where it is an uncontested record fact that Gulf & Western was actually paid the entire amount sought to be recovered as profits on the sale of its Allis-Chalmers stock, it would be little more than a fiction itself to exclude such sums from "any profit realized".

Nor is the Court of Appeals' holding as to the profits realized in this case contrary to rules used by other Courts of Appeals. The cases cited by cross-petitioner in support of its claim that the only proper measure of profit realized under Section 16(b) is the hypothetical value as of the date of purchase or sale (Cross-Pet. at 9; Pet. App. at 34a), involved, without exception, securities for which there was no other evidence available at the time of trial as to profits other than market data or evaluations of assets or securities based upon expert testimony. *See, e.g., Newmark* v. *R.K.O. General Corp.*, 425 F.2d 348, 356-58 (2d Cir.), *cert. denied,*

400 U.S. 854 (1970); *Stella* v. *Graham-Paige Motors Corp.*, 259 F.2d 476, 478 (2d Cir. 1958), *cert. denied*, 359 U.S. 914 (1959). *See also Mueller* v. *Korholz*, 449 F.2d 82, 86-87 (7th Cir. 1971), *cert. denied*, 405 U.S. 922 (1972) and *Blau* v. *Lamb*, 363 F.2d 507, 527 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967). None of those cases involved a short-term debt security the full face amount of which had been paid in full to the violator of Section 16(b). Unlike cases in which a court was faced with determining the Section 16(b) profits realized by valuing securities for which only expert or market data were available, this case involved the unusual situation of uncontroverted evidence of precisely what amount of money was actually received by Gulf & Western. To suggest, as does cross-petitioner, that "the actual value the [White] note produced for Gulf & Western" must be discounted by any amount whatsoever when the entire face value of the note was paid in full would permit Gulf & Western to retain a portion of those profits it actually realized on the sale of its Allis-Chalmers stock to White. (Pet. App. at 33a.) By looking to the "realities of this case", the rule the Court of Appeals applied to measure the actual "profit realized" by Gulf & Western "avoid[ed] the possibility that real profits will escape the reach of the statute or that non-existent profits will be recovered". (Pet. App. at 34a.) As the Court of Appeals for the Second Circuit observed in *Park & Tilford, Inc.* v. *Shulte*, 160 F.2d 984, 988 (2d Cir.), *cert. denied*, 332 U.S. 761 (1947):

> "Under the statute the amount recoverable by plaintiff is the receipts from the sale of the stock, minus the actual purchase price."

Section 16(b) was designed as a remedial statute. Congress attempted to discourage insider trading by taking

all of the profit out of a class of transactions in which the potential for abuse had been deemed present. The statute provides no flat prohibition on short-swing purchases and sales themselves but seeks only to render such transactions unprofitable. *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 422 (1972). To require Gulf & Western to disgorge *all* of the profits it actually realized as a result of its short-swing purchase and sale of 248,000 shares of Allis-Chalmers common stock, accords with the Congressional purpose and the express statutory language that "any profit realized . . . shall inure to and be recoverable by the issuer". To sanction any other rule in a case such as this would ignore both the plain language and the prophylactic purpose of Section 16(b). We submit that neither precedent nor logic supports the position urged by Gulf & Western.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the cross-petition for a writ of certiorari should be denied.

Dated: New York, New York
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Respectfully submitted,

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CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Gulf & Western Industries, Inc. ("G&W") cross-petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit entered on September 29, 1975.

A petition for certiorari was filed by Allis-Chalmers Manufacturing Company ("Allis"), the respondent herein, on October 16, 1975 (No. 75-580), with respect to a different aspect of the opinion below, and G&W has filed its "Brief for Respondent in Opposition," dated November 15, 1975, in answer to that petition. Abbreviations, citations and defined terms used herein follow those in G&W's brief in No. 75-580.

Opinions Below, Jurisdiction and Statute Involved

The statute involved is §16(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78p(b). The text of the statute and the other captioned matters are adequately set forth in the petition and brief in opposition in No. 75-580.

Question Presented

Whether the court below erred in departing from the long-established rule that in order to determine whether "any profit" was realized under §16(b), the elements of consideration must be assessed at their fair market value on the date of the transaction, and in creating instead a new rule under which an unsecured six-month $93,680,000 corporate note was valued at its face amount as a matter of law because ultimately paid, thus disregarding the trial court's finding of fact that the note was worth much less on the transaction date, which finding was supported by extensive evidence and was not held to be "clearly erroneous."

Statement of the Case

A comprehensive statement of the case is set forth in the aforesaid brief filed by G&W in No. 75-580. To avoid burdensome repetition, the instant statement assumes familiarity with the prior statement and is confined to facts bearing upon the question presented, which involves the artificial valuation by the court below of a $93,680,000 unsecured 6 month 8½% promissory note issued by White Consolidated Industries, Inc. ("White") as part of the consideration paid to G&W for its Allis shares (the "White note").

On October 31, 1968 G&W and White announced that White would acquire all of G&W's shares of Allis common stock, paying in consideration therefor 250,000 shares of White's common stock and $113,680,000 in cash (Dx-GGGG, ex. 4). However, in the period intervening before the December 6 closing, White was unable to raise even one-fifth of the required cash payment. Reflecting this circumstance, the final form of the parties' agreement* did not require the cash payment. Instead it allowed White an alternative of paying only $20 million in cash and presenting the aforesaid $93,680,000 promissory note (1163a-64), thus requiring G&W to finance White's purchase. White represented that it had received "telephonic commitments" from banks for approximately $50 million of the missing $93 million (1176a), but it was shown that these were infirm commitments, implicity conditioned upon White's obtaining the balance (920a). The agreement required White to pay promptly to G&W all funds obtained to discharge its indebtedness, but at the December 6 closing White had gathered only $20 million and thus delivered its note instead (1175a-76a, 1506a).

The White note constituted a substantial risk, and G&W tried to sell it shortly after the December 6 closing and then again in March 1969. The head of the corporate debt department of one of the nation's leading investment banking houses testified that, on both occasions he was asked to consider purchase of the note, he made a thorough credit study of White and found it to be "in a very unstable, unhealthy financial condition" (496a). He decided that the note was "not financible," and could only be sold through "non-money market agents such as factors" at a discount of 10 to 15 percent from face value. He so advised G&W, and he declined to buy the White note on his firm's behalf or accept it for resale to others (485a-86a, 489a, 497a).

In proceedings instituted by Allis to challenge White's acquisition of Allis shares—while the note was still out-

*The agreement between G&W and White was dated "as of" October 31, 1968, but was not in fact drafted until later, and in original form reflects last-minute changes in different typefaces (Px-12). As reprinted in the joint appendix, the difference in type faces has been eliminated (1163a *et seq.*).

standing—White's chief financial officer gave evidence that if White's investment in Allis common stock was in any way restricted, White would suffer "serious adverse" financial consequences and would be "incapable of amortizing" the debt incurred in acquiring its shares and still continue in business in the ordinary course (1520a). Allis thought this public concession to be so important that it issued its own press release to underscore it (1538a).

Extensive expert financial testimony and other evidence was adduced by both sides concerning the fair value of the White note on December 6, 1968, the date on which G&W received it. Despite different conclusions as to its value, there was general agreement among the experts on two premises: First, that the value of the White note when received by G&W could be determined only by consideration of a number of factors bearing upon whether, when, and to what extent White would be able to discharge the note, including current money-market conditions, White's financial position and the specific characteristics of the note. Second, Allis' own expert testified that the fact the note was ultimately paid in March 1969 "would not be competent evidence" of its value when received by G&W (831a-33a; 1526a). Other witnesses agreed that reliance on subsequent payment was fallacious and an improper use of hindsight, because it is the "very factor of *risk inherent in foresight which determines the valuation issue*" (1526a, emphasis original; 1379a).

The evidence offered on the value of the note was detailed and extensive, and included *inter alia:* G&W's inability to sell it at face value (485a-86a, 489a, 497a); White's own admission as to its potential inability to pay the note (1520a); lack of any security or basic protective covenants (1367a, 1523a); its unusually large amount (502a, 838a, 1517a-18a); its illiquidity (936a, 1368a); the very tight and near chaotic state of the money market (891a, 1514a-16a); the financial condition of White, including its "heavy debt" (496a, 856a, *66a*), its severely wanting "fixed

charges coverage ratio" (914a-17a); the top-heavy ratio of White's long-term debt to net worth (1369a); the uncertainty underlying White's proposed acquisition of Allis (1519a-21a, 1386a); and concluding assessments that the note had a value of from 80% to 93% of its face amount when issued to G&W by White on December 6, 1968 (1371a, 1528a, 496a-497a).*

The sequence of events ultimately leading to the payment of the note illustrated the expert witnesses' conclusion that White's chances of obtaining funds to discharge the note depended largely upon whether its proposed takeover of Allis seemed likely to succeed (1518a-1522a, Px-104 at 15). Such takeover of Allis was White's express purpose in acquiring the Allis shares (1507a), and on December 6, 1968 this prospect was in doubt.** Twelve days after the sale of the shares to White, Allis sought an injunction in the federal district court in Delaware to block White's acquisition on antitrust grounds (1519a). It was in that

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* To support its position that the note should be assessed at face value, Allis largely relied upon its claim that certain of G&W's financial statements had listed the note at its face amount while it was outstanding. However, neither of the courts below gave weight to this contention since there was uncontradicted expert testimony that accounting principles required such treatment because the question of default would be resolved within one year (446a-56a). Moreover, all courts have held that accounting treatment does not bind § 16(b) determinations, since accounting conventions do not correspond to the market value tests of § 16(b). *See, e.g., Stella* v. *Graham-Paige Motors Corp.* (3 decisions), 132 F.Supp. 100, 110-11 (S.D.N.Y. 1955), *aff'd*, 232 F.2d 299, 302 (2 Cir.), *cert. denied*, 352 U.S. 831 (1956); 259 F.2d 476, 481-82 (2 Cir. 1958), *cert. denied*, 359 U.S. 914 (1959).

** As of December 6, 1968 the success of White's proposed takeover was subject to considerable uncertainty. Allis had successfully fended off other unwanted suitors (Dx-GGGG, ex.4), and had just secured a new president (1519a). An FTC investigation to examine the proposed acquisition by White under the antitrust laws had already begun (Dx-GGGG, ex.5). Allis' management publicly announced that it planned no merger with White (*id.*).

action that White's chief financial officer admitted White's potential default on the note (1520a). The district court denied Allis' application on January 22, 1969, *Allis-Chalmers Manufacturing Co.* v. *White Consolidated Industries, Inc.*, 294 F.Supp. 1263 (D. Del. 1969), and on February 3 the Court of Appeals for the Third Circuit denied Allis' application for a temporary restraining order pending appeal, 414 F.2d 506, 509, n. 5 (3 Cir. 1969).

Given an apparent green light for the acquisition, White on March 5 was able to obtain a two year credit agreement with a number of banks and thereby obtain funds to discharge the note, which was still held by G&W following its failure to sell it (1219a). On March 20, White caused the note and accumulated interest to be paid (1295a).

However, after the risk had thus been transferred to the banks, Allis succeeded in turning White's situation around. On May 5, the Court of Appeals for the Third Circuit enjoined the holding of the annual meeting where White hoped to gain control of Allis (1536a; 414 F.2d at 509 n.6). On July 18, 1969 it reversed the district court, enjoined White from voting any or acquiring additional Allis shares or taking action to secure board representation, and thereby halted White's takeover attempt (414 F.2d at 526). As a result, White's banking creditors became "very concerned" and sought relief from the risk by seeking longer-term financing from other sources because of White's financial plight (499a-500a).*

*No such refinancing could be arranged until more than two years later, after White wholly abandoned its takeover bid and reduced its financial commitments (500a; 1253a).

The Decision of the District Court

The district court held that the value of the White note had to be determined, like that of all other consideraton, as of December 6, 1968, the date on which G&W sold its shares and acquired the note; that the test was the "realistic market value" of the White note on the valuation date; that valuations under § 16(b) cannot be based on hindsight, which is essentially erroneous and incompetent *(64a);* and that the note's characteristics, its size, the promissor, the interest rate, and its terms defined it as a hybrid instrument which, "considering a comprehensive evaluation of the opinion of the experts," could have been salable only at a discount (*65a*). The court gave consideration to assessments of White's financial condition, its heavy debt, the unusual nature of the note, the interest rate and the tight money market, and decided that a discount of 5% from face value represented its fair value on December 6, 1968 (*66a*).

The Decision of the Court of Appeals

The court of appeals acknowledged that the valuation of the White note at ninety-five percent of its face amount was "intended to account for the risk factors involved in a note of this size and produce a value" reflecting fair market value (*32a-33a*). It did not question the accuracy of, or foundation for, the district court's finding. Rather, it held that the "difference between the market value of the note" on December 6 and the amount paid on satisfaction of the note three and one-half months later should be added to the recovery as part of the "profit realized". Giving as its reason the general "remedial purpose" of §16(b), the court held it to be a rule of law that (whatever the actual value of the note when it was subject to the risk of nonpayment and whatever the magnitude of that risk) "debt obligations" are to be retroactively valued at face amount if paid in full sometime before trial (*33a*).

The impact of the court of appeals' holding would have exceeded $4 million, had the court not held that the 3,000,000 shares initially acquired by G&W in an Exchange Offer were outside the coverage of §16(b). The latter holding is the subject of Allis' petition in No. 75-580.

Reasons for Granting a Cross-Writ of Certiorari

A cross-writ of certiorari should be granted for several independently sufficient reasons, in that the holding below: (1) is clearly wrong as to an elemental and recurring question in the application of an important federal statute and departs from the overwhelming consensus governing computation of profits under §16(b), thus creating a conflict among the courts of appeals; (2) constitutes a plain circumvention of the mandate of Rule 52(a) F.R.C.P. that the trial court's findings of fact "shall not be set aside unless clearly erroneous"; and (3) is in irreconcilable conflict with *Blau* v. *Lehman,* 368 U.S. 403 (1962), in rationale and result.

In precise statutory terms, §16(b)'s impact is simply to make "any profit" in a set of matched transactions recoverable. 15 U.S.C. §78p(b). As indicated in the Congressional hearings, the statutory purpose was not to deny the investor proper credit for economic costs he had borne or the consideration he had paid, but expressly allowed the investor to "get out what he put in". *Hearings on S. Res. 84 and S. Res. 97 Before the Senate Committee on Banking and Currency,* 73d Cong., 2d Sess., at 6557 (1934). The computation of profit is, under §16(b), a "substantive question fundamental to plaintiff's recovery. It is not merely a question of damages which can be resolved upon an accounting." *Blau* v. *Lamb,* 163 F.Supp. 528 (S.D.N.Y. 1958). See also *Lewis* v. *Nadaline,* [1973-74 Transfer Binder] CCH Fed. Sec. L. Rep. ¶94,507 (S.D.N.Y. 1974); *Kramer* v. *Ayer,* 317 F.Supp. 254 (S.D.N.Y. 1970).

To fulfill the statutory criteria, the plaintiff must establish the value of the consideration given up and received, on and as of the dates when the alleged purchase and sale occurred. Every court which has previously considered the question has held that the statute requires the court to determine the fair value of the elements of consideration "on the day" of the transaction, and that such value is to be established by market evidence and expert testimony, *Stella* v. *Graham-Paige Motors Corp.,* 259 F.2d 476, 481 (2 Cir. 1958), *cert. denied,* 359 U.S. 914 (1959); ***accord, Newmark*** v. *RKO General Corp.,* 425 F.2d 348, 357 (2 Cir.), *cert. denied,* 400 U.S. 854 (1970); ***Blau*** v. ***Mission Corp.,*** 212 F.2d 77, 81 (2 Cir.), *cert. denied,* 347 U.S. 1016 (1954); *Park & Tilford, Inc.* v. *Schulte,* 160 F.2d 984, 988 (2 Cir.), *cert. denied,* 332 U.S. 761 (1947); ***Lewis*** v. ***Dekcraft Corp.,*** [1974-75 Transfer Binder] CCH Fed. Sec. L. Rep. ¶94,905 (S.D.N.Y. 1974); *Lewis* v. *Nadaline, supra; Gold* v. *Scurlock,* 324 F.Supp. 1211, 1216 (E.D. Va. 1971), *aff'd in pertinent part sub nom. Gold* v. *Sloan,* 486 F.2d 340 (4 Cir. 1973), *cert. denied,* 419 U.S. 873 (1974); *Kramer* v. *Ayer, supra; Champion Home Builders Co.* v. *Jeffress,* 385 F.Supp. 245 (E.D. Mich. 1974).

The holding below represents a deviation from this long-established rule. With scarcely a statement of reasons, the court swept away established statutory interpretation, hundreds of pages of expert economic evidence, the unequivocal testimony of a contemporary market-maker that the note had not been worth par, and the considered fact-finding of the district court (*33a*). In economic result, the court arbitrarily denied G&W credit for the risks it bore as the holder of the note during a critical and highly uncertain period when White was unable to obtain financing. These risks represented a genuine and universally recognized economic cost which was ascertainable in amount through the testimony of the several expert witnesses below and confirmed by events occurring while the note was out-

standing. In short, the court created the fiction that G&W had been paid entirely in cash on the date of the sale, while precisely the opposite occurred. Instead G&W accepted a note worth much less than face value, and bore its risk during the period when the question whether, when and to what extent the note's holder would be paid was unanswered.

This is a contrived result which cannot be defended on economic or statutory grounds, and it is at odds with uniform precedent. It even conflicts with the testimony of Allis' own economic expert that the later payment of the note "would not be competent evidence" of its value on the date of the transaction (831a-33a). The court expressly adopted the economically erroneous principle that subsequent events can establish value by "hindsight", even though the risk and uncertainty of payment is what establishes value. As one expert below stated, fair value cannot be shown by "hindsight" because it is the very factor of risk *inherent in foresight which determines the valuation issue*" (1526a) (emphasis in original).

The holding not only contravened the testimony and uniform precedent, but in its operation directly conflicts with the holding of the Second Circuit in *Stella* v. *Graham-Paige Motors Corp., supra,* 259 F.2d at 479, that under § 16(b) it is impermissible for a party to "substitute his hindsight judgment" for contemporaneous conditions which determine market value on the relevant date. Under the ruling below, whatever the prior risks and whatever the real value of a "debt instrument"—bond, note or debenture—payment prior to the time of trial will arbitrarily be substituted for the value the defendant actually received on the date of the transaction.

The vice which underlies the ruling is that it masks the unexpressed substitution by the court of appeals of its own

second-hand response to the trial evidence without coming to grips with the requirements of Rule 52 of the Federal Rules of Civil Procedure, which constrains all appellate review of factual determinations to honor the clearly erroneous rule. *United States* v. *General Dynamics Corp.,* 415 U.S. 486, 508 (1975); *Blau* v. *Lehman, supra,* 368 U.S. at 407. Yet the detailed and extensive economic evidence adduced at trial fully supported the district court's conclusion.*

*There was undisputed, concrete evidence of the risks of the note while it remained unpaid. G&W tried unsuccessfully to negotiate the note at face value with a third party market-maker shortly after December 6 and again in March 1969 (497a). In addition, while the note was still outstanding, White's chief financial officer gave evidence in the injunction suit brought by Allis that if White's efforts to acquire control of Allis were inhibited in any way, it would be impossible for White to pay the note and continue in business (1520a).

The evidence showed, *inter alia,* that the size and risks of the note both in absolute terms and relative to White's financial position were "enormous" and "unusual" (502a, 838a, 1517a-18a); that it was wholly unsecured, bereft of even the most basic protective covenants, without even a "negative mortgage clause" (1367a, 1523a); that it was a "severe strain" on White (1519a); that it was not marketable (1368a); that its illiquidity commaded a discount (936a, 1368a-69a); that the prevailing money-market climate was "one of the toughest markets that we had seen" (891a, 1514a-16a); that while the note was outstanding White was adjudged to be "in a very unstable, unhealthy financial condition" (496a) and upon issuance of the note White's obligations exceeded its net worth by a ratio of 147% (1369a); that White's fixed-charges-coverage ratio, upon which Allis' expert had relied, was erroneously calculated, very much lower and "very severely wanting" (914a-17a); that in two months of effort, White could only raise $20 million, had an absolute deficiency of $43 million, and an infirm possibility of access to $50 million only if all the money could be obtained (920a, 1523a); that the Allis stock did not collateralize the note and in any event was poor collateral which resolved into an equity risk, thus mandating a discount (1386a-87a, 1524a-25a); that *no one* (but G&W) would have been willing to buy the note unless others came in to share the risk—to provide the safety of diversification which G&W did not enjoy (1385a, 1517a-18a); and that White's access to financing depended upon the prospect that it could acquire Allis, which was gravely in doubt (1519a-21a, 1386a). Indeed White succeeded in borrowing funds to pay the note only after Allis had initially been stopped in its efforts to block White's acquisition (1221a).

The error of the court below thus lies not in the misapplication of a rule of law to the facts of a particular case, but rather in the creation of an unacceptable "rule" to compensate for its manifest failure to review those facts as required before disturbing the findings of the trial court. The only support claimed by the court below for its departure from the uniform rule was the "broad remedial purpose" of the statute and its aim of "reducing difficulties in proof" (*33a*), but this rationale cannot stand. In the first place, the proof involved here was of a commonplace variety. More significantly, the Seventh Circuit's underlying rationale, which superimposes a further prophylactic rule on an already prophylactic statute to overturn a finding of fact, was expressly rejected by this Court in *Blau* v. *Lehman, supra.*

There, because of alleged difficulties in proof, potential evasions, and supposed "policy arguments", 368 U.S. at 403, the Court was urged to extend §16(b) liability to include all partnership profits, by treating a partnership as a statutory "insider" if a partner was one. The Court rejected that expansive approach, stating that liability is not to be determined by "adding to the prophylactic effect Congress itself clearly prescribed in §16(b)." *Id.* at 414. It emphasized that the district court's factual findings could not be disturbed because "not clearly erroneous." *Id.* at 407.

In *Blau* v. *Lehman, supra,* the Court held that it would be "nothing but a fiction" to treat the defendant as having realized all the partnership's profits. 368 U.S. at 414. Here, the court below created a fiction in holding that G&W must be treated as having received cash on the date of sale. The proof was exactly the contrary, the clear interim risks of holding the note were arbitrarily erased, and the result reached by the court below was plainly unjust and erroneous.

CONCLUSION

For the reasons set forth above, G&W prays that a cross-writ of certiorari issue to review that aspect of the judgment below set forth in the question presented herein.

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Respectfully submitted,

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